

Mbhashe Municipality

Audit Report

For the year ended 30 June 2014

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MBHASHE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of Mbhashe Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

6. Irregular expenditure of R39.6 million is disclosed in note 28 to the financial statements. The municipality did not obtain the written approval from the relevant condoning authority for the condonement of irregular expenditure of R75 million, as required by section 170 of the MFMA. In addition, the municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. Consequently, irregular expenditure is understated in respect of the condonement of R75 million. Owing to the lack of

systems, it was impracticable to determine the full extent of the understatement of irregular expenditure.

Property, plant and equipment

7. The municipality did not account for its property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*, in the following circumstances:
 - Land and buildings were not classified in accordance with GRAP 17, *Property, plant and equipment* and GRAP 16, *Investment property*. The municipality incorrectly classified items of property, plant and equipment as investment property even though they are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes,
 - Items of investment property were duplicated in property, plant and equipment,
 - Residual values and depreciation methods were not reassessed during the year,
 - Depreciation was not calculated in accordance with the accounting policy.

Consequently, property, plant and equipment as disclosed in note 7 is overstated by R22.7 million, accumulated surplus as disclosed in the statement of financial position is understated by R23.5 million, depreciation as disclosed in the statement of financial performance is understated by R163 807 and investment property as disclosed in note 6 is understated by R964 539.

8. In addition, I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment due to the following matters:
 - Land and buildings are not separately identifiable on the asset register,
 - Amounts as per the fixed asset registers did not agree to the financial statements,
 - Assets could not be physically located during the audit,
 - Assets identified from the floor could not be traced to the asset register,
 - Additions to the electrification project in progress could not be physically verified and I was not provided with sufficient appropriate audit evidence supporting the project's progress during the year,
 - I was not provided with sufficient appropriate evidence for disposals during the year.

I was unable to confirm the amount of property, plant and equipment by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant and equipment of R238.2 million (2013: R118 million) and depreciation of R33.2 million as disclosed in the statement of financial performance.

Investment property

9. I was unable to obtain sufficient appropriate audit evidence for investment property due to the following matters:
 - Land and buildings are not separately identifiable on the asset register,
 - Assets could not be physically located during the audit,
 - Assets identified from the floor could not be traced to the asset register,
 - Right to ownership of the assets could not be determined.

I was unable to confirm the amount of investment property by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to investment property of R53.5 million and depreciation of R220 913 as disclosed in the statement of financial performance.

Employee costs

10. The municipality did not account for its employee costs in accordance with GRAP 25, *Employee benefits*, in the following circumstances:

- A councillor received payment after their services had been terminated,
- Leave gratuity payments were incorrectly calculated and paid,
- The leave accrued for at year end was not calculated correctly.

Consequently, employee costs as disclosed in notes 19 and 20 is overstated by R1.2 million, receivables from non-exchange transactions as disclosed in note 35 is understated by R151 237 and payables from exchange transactions is overstated by R1 million.

11. In addition, I was unable to obtain sufficient appropriate audit evidence for employee costs as I was not provided with sufficient appropriate evidence for the following matters:

- Overtime,
- A reconciling item between the payroll system and the accounting system,
- Contributions made on behalf of employees to a medical scheme which is not accredited by SALGA.

I was unable to confirm the amount of employee costs by alternative means.

Consequently, I was unable to determine whether any further adjustments were necessary to support employee costs of R57 million as disclosed in notes 19 and 20 to the financial statements.

Consumer debtors

12. The municipality did not have adequate systems in place over the billing of debtors in that interest was not charged on overdue accounts. I was also not provided with evidence to support indigent debtors' applications. I was unable to confirm the consumer debtors and interest income by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to consumer debtors of R521 565 as disclosed in note 4 to the financial statements and interest income of R6 million as disclosed in the statement of financial performance.

Qualified opinion

13. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Mbhashe Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material underspending of conditional grant

14. The municipality has materially underspent on the Municipal Infrastructure Grant (MIG). The unspent portion of the conditional grant for the MIG amounts to R20 million as at 30 June 2014 and is disclosed in note 14 to the financial statements.

Material impairments

15. Disclosed in note 4 to the financial statements are impairments of R20.9 million (98%) that were provided for in respect of Consumer debtors.

Additional matter

I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

16. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for objective 2: Basic Service Delivery and Infrastructure on pages x to x presented in the annual performance report of the municipality for the year ended 30 June 2014.
19. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
20. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. The material findings in respect of the selected objectives are as follows:

Basic Service Delivery and Infrastructure

Usefulness of reported performance information

Consistency of objectives, indicators and targets

23. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved integrated development plan. This was due to the municipality operating without an adopted reviewed framework.

Measurability of indicators and targets

24. The National Treasury Framework for Managing Programme Performance Information (National Treasury FMPPI) requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance must be measurable and the period or deadline for delivery of targets must be specified.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

25. The measurability of planned targets and indicators could not be assessed due to a lack of proper systems and processes, formal standard operating procedures and documented system descriptions.

Relevance of indicators

26. The National Treasury FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The relevance of the indicators could not be assessed due to a lack of corroborative supporting evidence to verify management's explanation why the indicators were considered important and relevant to the realisation of strategic goals and objectives.

Reliability of reported performance information

27. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due to the absence of information systems and the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matter

28. I draw attention to the following matter :

Achievement of planned targets

29. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the disclaimer of conclusions expressed on usefulness and reliability of the reported performance information in paragraphs 24 to 28 of this report.

Compliance with legislation

30. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Procurement and contract management

31. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act (PPPFA) and its regulations.

32. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

33. Sufficient appropriate audit evidence could not be obtained that all extension or modification to contracts were approved by a properly delegated official, as required by SCM Regulation 5.

34. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
35. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
36. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
37. Awards were made to providers who are in the service of other state institutions or whose directors/ principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

Strategic and performance management

38. The local community was not consulted by means of a municipal wide structure for community participation or through a forum that enhances community participation in drafting and implementing the Integrated development plan (IDP), as required by section 28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).
39. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.
40. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
41. The local community was not afforded the opportunity to comment on the final draft of the IDP before adoption, as required by section 42 of the MSA and Municipal planning and performance management regulation 9, 13(1), 13(4)(c) and 15(3).
42. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
43. The performance of the municipality were not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.

Annual financial statements, performance and annual reports

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and/or the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.
45. The 2012/13 annual report was not tabled to Council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
46. A written explanation was not submitted to Council setting out the reasons for the delay in the tabling of the 2013/14 annual report in the Council, as required by section 127(3) and 133(1)(a) of the MFMA.

Human resource management and compensation

47. An acting Municipal Manager was appointed for a period of more than six months, in contravention of section 54A(2A) of the Municipal Systems Act (MSA).
48. Managers directly accountable to municipal manager were appointed without submitting proof of previous employment and disclosure of financial interests in contravention of regulation 4 of GNR 805.
49. Sufficient appropriate audit evidence could not be obtained that the senior managers were never dismissed for financial misconduct in a previous position and re-appointed before the expiry of 10 years in contravention of section 57A of the MFMA.
50. The competencies of financial officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels reg 13.
51. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Regulations on Minimum Competency Levels reg14(2)(a).
52. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Regulations on Minimum Competency Levels reg 14(2)(b)/14(3).
53. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of MSA sec 67(d).

Expenditure management

54. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue Management

55. A tariff policy was not adopted and implemented for the levying of fees for provision of municipal services, as required by section 74(1) of the MSA and section 62(1)(f)(i) of MFMA.
56. A credit control and debt collection policy was not maintained and implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.
57. A policy was not adopted and implemented for the levying of rates on rateable property within the municipality, as required by section 3(1) of the Property Rates Act and section 62(1)(f)(ii) of MFMA.
58. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) and 97(i) of the MFMA.
59. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

60. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
61. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
62. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the MFMA and Municipal investment regulation 3(1)(a).

63. Capital assets were sold, transferred or permanently disposed that were needed to provide the minimum level of basic municipal service, in contravention of section 14(1) of the MFMA.
64. Capital assets were sold, transferred or permanently disposed without the approval of the council or the accounting officer, as required by section 14(2)(a) of the MFMA.

Consequence management

65. The condonation of irregular expenditure was not approved by the appropriate relevant authority, as required by section 1 and 170 of the MFMA.

Internal control

66. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

67. The lack of accountability and vacancies in numerous positions resulted in action plans to address audit findings relating to misstatements in the financial statements, compliance with laws and regulations and performance against predetermined objectives not being implemented adequately. The lack of approved policies contributed to non-compliance with legislation and inadequate controls. There has been inadequate oversight by leadership and a slow response to the key messages. As in prior years, deficiencies in human resource and performance management were identified. This was due to management not effecting timeous change in the municipality and vacancies in these key departments. Improvement is dependent on the proper execution of the action plans drafted, which were not fully implemented in the current year.

Financial and performance management

68. Various documents received for audit purposes lacked quality and completeness, indicating that filing systems at a floor level are a contributing factor to the misstatements identified. The municipality does not apply best practice in its daily and monthly control activities and audit recommendations have not been adequately addressed in the current year. The financial statements and the annual performance report contained numerous misstatements that were not detected and corrected, indicating that staff members did not fully understand the requirements of the financial reporting framework and performance information requirements. This is as a result of a lack of supervision, monitoring and consequence management in respect of the reporting process.
69. The municipality does not have systems in place to monitor compliance and prevent non-compliance with all applicable legislation. Non-compliance with laws and regulations could have been prevented had compliance been properly reviewed and monitored.

Governance

70. There was no effective oversight review over financial information, compliance with laws and regulations and reporting on predetermined objectives, as recurring findings in these areas were identified during the year. This is a critical area for the all oversight bodies to address going forward.

Auditor General -SA

East London

28 November 2014



Auditing to build public confidence